Asia Credit Research

Earnings Review: DBS Group Holdings Ltd ("DBS")

Recommendation

- 1Q2018 results reflect supportive business conditions and DBS's ability to benefit from it as earnings and balance sheet growth reinforce the bank's strong fundamentals. Our Positive (2) Issuer Profile is retained.
- With underlying performance consistent with our constructive sector outlook for financial institutions, we tend to look to other names and lower in the capital structure for higher yield as the DBS curve continues to trade tight.
- We currently rate the Australian banks also at a Positive (2) Issuer Profile and see the ANZ 3.75% '27c22s as being the better value in the Aussie Tier 2 space.

Relative Value:

Bond	Maturity / Call date	CET1 Ratio	Ask Yield	Spread
DBSSP 2.78 '21 (Snr)	11/01/2021	14.0%	2.67%	55
DBSSP 4.7 PERPc20 (AT1)	22/11/2020	14.0%	2.31%	22
DBSSP 3.8 '28c23 (T2)	20/01/2023	14.0%	2.72%	38
DBSSP 4.7 PERPc19 (AT1)	03/06/2019	14.0%	2.27%	46
ANZ 3.75 '27c22 (T2)	23/03/2022	10.8%*	3.24%	99

Indicative prices as at 30 April 2018 Source: Bloomberg
*Common Equity Tier 1 (CET1) Ratio based on latest available quarter *APRA Compliant*

Issuer Profile: Positive (2)

Ticker: **DBSSP**

Background

DBS Group Holdings Limited ('DBS') primarily operates in Singapore and Hong Kong and is a leading financial services group in Asia with a regional network of more than 280 branches across 18 markets. With total assets of SGD529.9bn as at 31 March 2018, it provides diversified services across consumer banking, wealth management institutional banking, and treasury. It is 29% indirectly owned by the government through Temasek Holdings Pte Ltd as of 30th April, 2018.

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Key Considerations

- **Earnings momentum from solid business conditions:** 1Q2018 results were strong with total income up 16% y/y to SGD3.4bn. This was driven by broad based growth across net interest income (+16% q/q due to loan growth and 9bps y/y improvement in net interest margins ('NIM') to 1.84%; NIMs also improved q/q by 5bps), net fee and commission income (+12% q/q due to wealth management and cards while investment banking and loans related income was weak) and other non-interest income (+25% q/q due to net trading income and net gain on divestment of a Hong Kong property while net income from investment securities was weak). In particular, the average rate on interest bearing assets improved 25bps y/y and 14bps q/q as interest rates rose from the start of the year although this was partially offset by a 17bps y/y and 9bps q/q rise in average rates on interest bearing liabilities.

- **Slower expense growth supporting profitability**: Expenses grew at a slower pace than total income, up 12% y/y and 3% q/q. Around half of the y/y growth came from higher staff related costs arising from the acquisition of Australia and New Zealand Banking Group Ltd's ("ANZ") Asian retail and wealth management businesses. Excluding this acquisition, expenses grew 6% y/y. Business growth also contributed to higher expenses. However, with the solid income growth, the cost to income ratio fell to 41.6% for 1Q2018 against 43.2% and 44.4% for 1Q2017 and 4Q2017 respectively. In addition, allowances for credit losses continued to fall (-18% y/y and -27% q/q) and this translated into profit before tax ('PBT') improving 25% y/y. Segment wise, all segments recorded growth in PBT y/y due to either business growth or improved expense management (including allowances for credit losses).

- **Balance sheet growth in line with the economy**: DBS's balance sheet grew in line with the solid operating environment with total assets up 10% y/y. This was driven by a 10% y/y growth in customer loans. Growth was still decent q/q with total assets and customer loans up 2%. Y/y loan growth was even across Consumer Banking / Wealth Management and Institutional Banking while the latter contributed to the bulk of loans growth q/q. Deposit growth was also solid (+10% y/y and +1% q/q) and as such the loan to deposit ratio was broadly stable at 87.3% q/q. Part of the reason for the jump in average cost of interest bearing liabilities (in addition to rising interest rates) was higher fixed deposits although growth in current and savings accounts was also solid.

- **Positive underlying trajectory in loan quality**: Loan quality metrics were weaker y/y due to the higher pro-active recognition of oil and gas support services exposures as non-performing in line with the implementation of Financial Reporting Standard 109 (which requires provisioning to be based on expected future credit losses rather than actual credit losses). Q/q performance was better, with non-performing loans falling 2.3% due to improvements outside Singapore. NPL's rose in Singapore slightly q/q by 2.6%.

- **Capital ratios remain robust**: Despite solid earnings performance, total capital growth was moderate (+3.0% y/y and +2.4% q/q) due to the full phasing in of CET1 regulatory adjustments from 1 January 2018. As such the movement in capital ratios (which was also driven by 2.5% q/q and 8.2% y/y growth in risk weighted assets from loans growth and contribution from ANZ's wealth management and retail banking business) on a fully phased in basis was not as much as the reduction in transitional ratios. The fully phased in CET1 ratio as at 1Q2018 was 14.0% against 13.9% for 4Q2017 (14.2% as at 1Q2017), still well above the CET1 regulatory minimum requirement of 8.7%. Additionally, DBS' leverage ratio of 7.6% remains well above the minimum Basel III requirement of 3%. The strong positions against regulatory requirements should support further potential balance sheet growth in 2018.

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Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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